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Tenth meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters

Report of the Secretary-General

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I. Introduction

1. Pursuant to Economic and Social Council decision 2001/208, the tenth meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters was held in Geneva from 10 to 14 September 2001 instead of in New York from 23 to 27 April 2001.

2. The Group of Experts observed that the process of globalization affected various developing countries and economies in transition in different ways. During the Millennium Summit organized recently by the United Nations, the participating Governments agreed that the benefits of globalization — faster and more sustained growth, higher living standards, more employment and large dividends from advances in technology — require concerted action at both the national and international levels and cannot be left to the operation of market forces alone. Globalization and its accompanying market forces should be properly guided and harnessed to become inclusive forces for sustainable and people-oriented development.

3. It was considered that although the evidence of the quantitative impact of globalization on public revenues is still limited, there are indications that it may reduce tax revenues due to increased tax competition among jurisdictions to attract foreign direct investment, the exponential growth of electronic commerce, the increased mobility of factors of production and the growing importance of off-shore and non-cooperative tax jurisdictions. The fall in revenues may further aggravate the problem of budgetary deficits of fiscally stretched economies. It was observed that globalization may also create pressures for increased spending on infrastructures for education, training, research and development, environment, economic and social welfare, as well as on institutional changes primarily to improve efficiency. Although those items of expenditure are consistent with the traditional and basic role of the State in its allocative function, globalization may create additional financial requirements for social protection in the form of unemployment benefits for unskilled labour facing retrenchment due to the closing of non-competitive domestic industries. To the extent that globalization is perceived to be a factor in the worsening of the income distribution of countries, it appears that globalization has increased the call for governmental intervention while it has at the same time reduced Governments' capacity to intervene due to reduced availability of financial resources.

4. In its resolutions 1980/13 and 1982/45, the Council defined the terms of reference of the Group of Experts as including, inter alia, the formulation of guidelines for international cooperation to combat tax evasion and avoidance and the study of possibilities for enhancing the efficiency of tax administrations and reducing potential conflicts among tax laws of various countries. With the significant growth of international trade and investment, tax authorities in developing countries and economies in transition face increasing challenges in assessing and collecting the taxes due to them from international transactions. The Group of Experts provides advisory services to the Secretary-General in strengthening the administrative and technical capacities of the tax administrations in developing countries and economies in transition through the organization of interregional workshops on international taxation and through technical cooperation and assistance.

5. The tenth meeting of the Group of Experts was attended by 21 tax experts and 34 observers. The United Nations Secretariat prepared the basic documentation and organized a meeting of the Steering Committee of the Group of Experts in Beijing in April 2001 to review the work of the Group of Experts on the revision and update of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*; transfer pricing; new financial instruments; electronic commerce and taxation; and mutual assistance in collection of tax debts. The Committee also formulated recommendations on the issues to be discussed at the tenth meeting of the Group of Experts.

6. The agenda for the tenth meeting was as follows:

1. Opening of the meeting.
2. Election of officers.
3. Adoption of the agenda and organization of work.
4. Revision and updating of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the *Manual for the Negotiation of Bilateral Tax Treaties*

between Developed and Developing Countries.

5. Transfer pricing.

6. New financial instruments.

7. Taxation of electronic commerce.

8. Mutual assistance in tax collection.

9. Other matters.

10. Arrangements for the eleventh meeting.

7. The discussion of the main items on the agenda is summarized below.

II. Revision and updating of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

8. The revised United Nations Model Double Taxation Convention between Developed and Developing Countries, which was published in June 2001, was presented to the participants in the tenth meeting. It was, however, noted that the work of revision and update of the United Nations Model Convention will continue in the light of structural changes taking place in the international economic, financial and fiscal environment, in particular the modifications currently being examined and proposed to certain basic provisions of double taxation conventions as a result of the impact of electronic commerce on international taxation.

9. The Group of Experts examined the draft revision of the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*. It was observed that although the draft makes certain revisions to the earlier edition published in 1979 that are necessary to remove obsolete provisions and clarify the meanings of the United Nations Model Convention, it does not address in detail various current issues, such as the taxation of electronic commerce and new financial instruments, which were to be discussed at the tenth meeting. The members of the Group of Experts expressed different points of view on the role of the United Nations Model Convention and the *Manual*. Although it was generally agreed that the United Nations Model Convention is the primary document and has priority over the *Manual*, it was also agreed that the two documents serve different functions. The *Manual* is intended as a major tool for educational and training purposes in international taxation for tax administrators of developing countries and economies in transition. Members of the Group of Experts from those countries emphasized the great usefulness of the *Manual* in enhancing the capacities, expertise and skills of their countries' negotiators of bilateral tax treaties. Some of the participants observed that in view of the recent publication of the Model Convention, the contents of the *Manual* would gain in clarity through additional updating of the commentary to ensure greater consistency between the contents of the United Nations Model Convention and the *Manual*.

10. The Group of Experts accordingly decided that participants would forward their comments, suggestions and editorial changes within one month to be considered for incorporation in the final version of the *Manual*.

III. Transfer pricing

11. The Group of Experts noted that although the transfer-pricing mechanisms increasingly being adopted by multinational enterprises and their group companies that are chargeable to tax in different national tax jurisdictions primarily aim to minimize their aggregate tax liabilities, several other non-tax issues or political factors come into play, such as artificial shifting of incomes to favoured divisions or transferring income from foreign subsidiaries to the parent corporation for more efficient utilization of funds.

12. One major developed country has taken a leading role in the development of the "arm's length" principle in dealing with transfer-pricing mechanisms. It presupposes that the standard to be applied in every case is that of an uncontrolled taxpayer dealing "at arm's length" with another uncontrolled taxpayer. That principle, which was adopted by the Organisation for Economic Cooperation and Development (OECD) in its guidelines (issued in 1979 and reinforced in 1995) for establishing transfer prices on cross-border transactions, is considered to be the best method of

taxing separate entities, thereby avoiding double taxation, minimizing the conflicts between tax administrations and promoting international trade. The revision of the guidelines has been extended to cover intangibles and services on cost contribution arrangements and guidelines for conducting advance pricing agreements (APAs) under mutual agreement procedures. However, the arm's length principle, using real transactions arising in the marketplace as the basis for the allocation of income, has created problems for developing countries and economies in transition due to limited markets in many types of goods and services and the lack of availability of comparable prices.

13. While discussing the problems faced by developing countries and economies in transition in determining proper transfer prices, it was observed that many of those countries, with a view to protecting their tax revenues and their balance of payments, are required to make special administrative efforts to fight against the indirect transfers of benefits outside the country through improper transfer prices. It was noted that such countries do not have adequate data on comparable prices and lack sufficient human and financial resources to deal adequately with the problem. The Group of Experts also discussed the possible use of an arbitration mechanism to settle disputes between taxpayers and the government on transfer-pricing issues. It was added that the taxpayer must feel confident that information provided to the government will be kept in confidence if an appropriate relationship between the government and the taxpayer is to be established.

14. A representative from a developed country discussed the arbitration convention of the European Union (EU). It was noted that although the EU convention defines an "associated enterprise" in accordance with article 9 of the United Nations and OECD Model Conventions, the scope of the EU convention is limited to the 15 members of the European Union. As a result, issues relating to affiliated companies resident in countries outside the EU are not within the scope of the convention. It was observed that a panel appointed to consider an arbitration case would have an equal number of members appointed by each country involved and an equal number of members drawn from experts nominated by the 15 members of the EU. Although no cases have yet been decided under the convention, it was suggested that the convention may be judged a success to the extent that it has caused member States to conclude competent authority cases in a timely manner. One member from a developed country indicated that his country is expecting to have a case under the convention in the near future.

15. Representatives of several countries discussed their experience with arbitration. It appears that arbitration is not used very often in practice. The main function of an arbitration option seems to be to put pressure on Governments to reach an agreement through the mutual agreement procedure based on article 25 of the United Nations and OECD Model Conventions. Several representatives of developing countries expressed the view that the mutual agreement procedure should be preferred. One participant noted that an arbitration procedure is likely to give the advantage to the side that is best represented in the procedure and that the multinational companies tend to be well represented. Several members suggested increased use of mediation as an effective means for resolution of transfer-pricing disputes.

16. It was also suggested that developing countries might find the use of safe harbours (also called "safe havens") to be a convenient way of dealing with some transfer-pricing issues. The difficulties in applying the arm's length principle may be reduced by providing circumstances in which taxpayers can follow a simple set of rules under which transfer prices would be automatically accepted by the national tax administration, which are commonly known as "safe harbours". It was suggested that that practice is most useful when the other country involved is prepared to accept the safe harbour rule. One participant suggested that taxpayers be given an option to use an arm's length method in place of the safe harbour. It was noted, however, that much of the administrative advantage of the safe harbour might be lost if that option were provided. There was a general consensus that the use of safe harbours might be explored but that their use should be limited to certain types of businesses and based on a good analysis of the profits likely to be earned in those businesses.

17. In the light of the above and despite the adoption of various adjustment methods and legislative and other multilateral measures to overcome the adverse consequences of transfer-pricing mechanisms during the past several years, the Group of Experts established a focus group composed of seven participants to review the current situation with respect to transfer-pricing

mechanisms and formulate recommendations to avert the loss of tax revenues from corporate strategic use of transfer prices. In particular, the focus group was expected to concentrate on the need to adjust the various transfer-pricing methods, review the mutual agreement procedures provided in article 25 of the United Nations Model Convention, define the appropriate framework for relevant mediation and arbitration procedures, and suggest ways to provide training and technical assistance to enhance the capacities of tax administrations in dealing with transfer-pricing mechanisms, particularly in developing and transitional economy countries.

18. On the basis of the report of the focus group, the Group of Experts recognized the need for developing and transitional economy countries to improve their ability to develop, implement and administer transfer-pricing rules in accordance with the arm's length principle of article 9 of the United Nations Model Convention and the OECD Model Convention. To that end, the Group of Experts identified two major areas in which action through concrete steps would be of particular benefit to developing countries and economies in transition (for the specific recommendations of the focus group, as endorsed by the Group of Experts, see para. 44 below).

IV. New financial instruments

19. New financial instruments, such as derivatives, including options, forwards and futures and their other variants, have assisted in meeting the global demand for financing international trade and investment and in reconciling the different needs of investors and borrowers. Such financial innovation has allowed corporations to insure themselves against various types of risk by transferring that risk to the financial sector, which has the beneficial effect of reducing the consequences of currency and interest rate movements for the corporate sector. In short, financial innovation in the form of derivative products can play a powerful role in encouraging prudent risk management.

20. However, those instruments have posed considerable difficulties in the application of tax rules based on traditional categories for the tax authorities in both developed and developing countries. In assessing the income attributable to a financial instrument, the conventional approach requires the ascertainment of the character of the income (as ordinary income, capital gain, interest or dividends); the time element when the income has accrued or been received; and whether the income is of domestic or foreign source and whether it is subjected to withholding tax at source. Those innovative financial instruments upset the aforesaid existing categories because of the possibility of converting one type of income or instrument into another or into a combination of different types that are often treated differently for tax purposes. Moreover, those systems of categorization are becoming increasingly difficult to maintain and administer in the light of the emergence of instruments that reflect the economic attributes of investments in diverse forms. The critical issue of determining the ownership of an instrument for tax purposes has also been tested by contracts that replicate, shift or eliminate some or all of the returns and risks of an investment. By contrast, it was observed that securities lending and repurchase arrangements that transfer the legal title but retain the economic attributes of an investment seem to present similar problems of identification of the "tax owner" of a position. It was further stated that the tax systems are being challenged by two broad and competing concerns — removing artificial tax barriers to effective risk management strategies and limiting the opportunities for tax arbitrage.

21. It was recognized that the new rules for the taxation of new financial instruments as used in domestic transactions would probably not be a priority in the immediate future for developing countries and countries in transition. It was expected that most countries would monitor their applicable accounting rules to ensure that there are no serious problems in accounting for income from new financial instruments for corporate income tax purposes. Four goals were identified for an ideal system for taxing income from innovative financial instruments: neutrality, whereby economically equivalent instruments would be taxed in the same way, irrespective of their legal form; equity; certainty; and administrability. It was observed that countries would have to be vigilant in applying transfer-pricing rules to cross-border transactions involving new financial instruments, which might require adequate legal authority to enable tax administrations to adjust transfer prices, wherever necessary, and the existence of a sufficient number of tax officials who are adequately trained to deal with the complex issues. It was also suggested that countries develop clear rules for associating new financial

instruments with local branches (permanent establishments) of non-residents, and that they ensure consistent and diligent application of rules.

22. It was observed that most countries may have an interest, consistent with the principles of existing bilateral tax treaty networks, in imposing withholding tax on cross-border payments under new financial instruments in certain circumstances, i.e., where the countries impose withholding tax on cross-border payment of interest; in cases where the payments represented a return on invested capital; and in cases where the payments represented excessive amounts used to siphon off earnings to related parties. It was also considered that countries which imposed withholding tax on interest paid to non-residents may extend that tax to original issue discount. There was a suggestion that the use of hybrid instruments on a cross-border basis to erode the domestic tax base could be appropriately countered by effective thin capitalization rules. In view of the fact that new financial instruments are being used to structure transactions whose legal form deviates from their economic substance, it may be necessary to introduce anti-avoidance legislation that enables tax administrations to challenge the re-characterized transactions according to their economic substance in appropriate cases.

23. It was suggested that different approaches could be undertaken by tax systems, such as reliance on financial accounting rules, which can offer greater consistency and reduced compliance costs; the disaggregation of financial instruments to isolate and identify different economic components separately for income tax purposes; the mandatory integration of certain offsetting transactions to prevent potential abusive transactions, and the application of broad anti-abuse rules that impose "substance over form" rules to combat tax arbitrage. It was considered that the above approaches could be taken, either individually or in combination, to develop appropriate responses to the challenges presented by innovative financial transactions.

24. Reverse convertible (exchangeable) bonds are substantially normal stock exchange issued bonds with an outstanding period of about two years, embodying a generally high-interest-bearing debt obligation. Their distinctive feature is that under the contract, the issuer at maturity has the choice of either repaying to the holder the face value of the bond in cash or transferring to the holder a certain number of shares of a third-party corporation. It was observed that the treatment of the income, if any, for income tax purposes creates many difficulties. At times, such instruments are treated as an interest-producing loan. Another approach treats their income as consisting of a portion considered to be an interest and a portion regarded as premium for a put option written by the holder, which was not treated as income under certain circumstances and not subject to tax. It was considered that such complex and hybrid financial instruments also posed considerable challenges to tax administration.

25. The Group of Experts noted that the greater flexibility afforded to taxpayers by the new financial instruments had expanded the opportunities for tax arbitrage. Tax systems of some developed countries appear to have responded to those concerns through different approaches, such as reliance on accounting rules; the disaggregation of transactions into discrete components; the integration of offsetting positions; the taxation of changes in value through "market-to-market" systems; and targeted anti-abuse rules. Although each of those methods has merit in certain circumstances, none of them provides a comprehensive solution to the tax issues referred to above. It was considered that tax authorities may invoke one or more of those methods in developing new rules in this area with a view to balancing the various tax policy objectives at stake and addressing the risk management needs of taxpayers. It was observed that the innovation and expanded use of new financial instruments tested the viability of the current frameworks of income tax systems and international tax agreements, and would continue to demand effective and appropriate responses.

V. Taxation of electronic commerce

26. "Electronic commerce" has been defined as "the ability to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques". Another descriptive and useful definition refers to "a wide array of commercial activities carried out through the use of computers, including online trading of goods and services, electronic fund transfers, online trading of financial instruments, electronic data exchanges between companies and electronic data exchanges within a company". The Group of Experts recognized

that electronic commerce is an important and rapidly growing segment of the economy that raises significant issues for both direct and indirect tax regimes. Even the most conservative estimates of the growth of electronic commerce indicate that it will play a more and more important role in the world's economy for developed and developing countries alike. The principal challenges for tax administrations were identified as the erosion or disappearance of the tax base, the difficulties in identifying the taxpayer and problems of tax enforcement.

27. It was observed that the taxation of electronic commerce should be technology-neutral so as to avoid preferential treatment to any form of commerce, and should be based on the principles of transparency, certainty, effectiveness, efficiency and non-discrimination. The problems of direct taxation of electronic commerce are fundamental but not urgent, whereas the problems of indirect taxation of electronic commerce are urgent but not fundamental. There is an international consensus that the rules for the consumption taxation of cross-border trade should apply in the jurisdiction where consumption takes place. With respect to such taxes, it was pointed out that there are essentially four types of transactions that may be characterized as involving electronic commerce: transactions involving electronic ordering of business-to-business supplies of tangible personal property; transactions involving electronic ordering of business-to-consumer supplies of tangible personal property; transactions involving business-to-business supplies of digital products or services; and transactions involving business-to-consumer supplies of digital products or services. Only the last category of transactions was thought to provide a truly difficult challenge for consumption tax administration. There are existing mechanisms, well known to taxing authorities, for controlling and enforcing consumption taxes with respect to tangible products, even when such products are sold in cross-border transactions involving remote suppliers. Moreover, it was pointed out that there is an effective mechanism for enforcing consumption taxes with respect to business-to-business supplies of digital products or services in a cross-border transaction — the reverse charge or self-assessment mechanism.

28. The main challenge to tax administration was represented by business-to-consumer transactions involving digital supplies. It was pointed out that the relative importance of the problem has, for the moment at least, been reduced by the fact that business-to-consumer digital commerce represents less than 20 per cent of e-commerce transactions, which are dominated by business-to-business transactions. Nevertheless, it was emphasized that those problems are likely to become more and more significant in the coming years, with the expected growth of business-to-consumer digital commerce. It was noted that there is currently considerable attention being given to the development of technology-based tax solutions to the problems raised by consumption taxation of electronic commerce. A member from a developing country raised the question whether those innovative technology-based solutions originated in tax-based or technology-based organizations, and questioned the relationship between the two. In response, it was pointed out that the private sector was currently developing the technology-based solutions, which drew on both tax and computer expertise. It was further pointed out, however, that the implementation of such solutions necessarily required a high degree of cooperation between taxing authorities and those "trusted third parties", who are developing and administering such technological solutions.

29. The problems of direct taxation of electronic commerce involve more fundamental issues than the problems of indirect taxation of electronic commerce because there is not as strong an international consensus on the underlying taxing principles with respect to the former as compared to the latter. Specifically, there is controversy over the application of the permanent establishment concept to the e-commerce environment, although some consensus appears to have been reached concerning the circumstances under which a server or web site may constitute a permanent establishment. More significantly, there is continuing controversy over the fundamental questions of how various types of transactions involving digital products should be characterized for income tax purposes and, consequently, the nature of the source of the income from such transactions.

30. In summary, it was pointed out that electronic commerce would inevitably become an increasingly important fact of economic life, even in developing countries and economies in transition. Despite the fact that the threat that electronic commerce currently poses to the tax regimes of developed economies (erosion of

the tax base) may appear, for the moment, to pose less of a threat to the tax regimes of developing countries and economies in transition, it was observed that it was of utmost importance for such countries to be actively engaged in the worldwide debate over the challenges posed by electronic commerce for tax administration. In particular, those countries may wish to consider developing the appropriate environment and legislation to promote development and taxation of e-commerce. Only if they do so will they be in a position to deal with — and benefit from — the growth of e-commerce and its inexorable impact on their economies and tax regimes. A member from a developing country suggested that the United Nations undertake research and new initiatives for determining the principles for taxation of electronic commerce, specifically concepts of permanent establishment, which may be useful to developing countries and economies in transition.

31. To a considerable extent, electronic commerce does not recognize national borders, because of which its taxation may have to be considered in a cooperative manner among Governments. Although income from electronic commerce is not an important part of the tax base of developing countries and economies in transition, it is anticipated that such income will become increasingly important in the future, particularly with respect to business-to-business transactions. Moreover, the increasingly important role of electronic commerce has significant implications for tax administration, namely, the widespread adoption of paperless tax reporting and remittance mechanisms, which will inevitably have an impact on all taxing authorities, even in countries without robust electronic commerce economies.

32. In the light of the potential importance of the taxation of electronic commerce to developing countries and economies in transition, the Group of Experts appointed a focus group to examine the question of proposed work on taxation of electronic commerce. The recommendations of the focus group, as endorsed by the Group of Experts, are contained in paragraph 45 below.

VI. Mutual assistance in tax collection

33. It was observed that the issue of mutual assistance in tax collection is not dealt with in article 26, dealing with the exchange of information, of the United Nations or OECD Model Conventions. The reasons for the failure to include a tax collection assistance clause in model conventions were attributed to the general principle of territorially limited state sovereignty: such territorial limitations, it was pointed out, can be overcome only by authorizing and altering enforcement conditions through an international convention, making it obligatory for a State to respond to requests for assistance by another State in recovering the latter's tax claims.

34. The objective of a provision in a bilateral tax treaty for assistance in recovery of outstanding tax liability is to facilitate the recovery of taxes beyond the State's own jurisdiction. Recovery beyond national borders cannot be implemented without a provision in a bilateral tax treaty on recovery. Where such an article has been included in the bilateral convention, an applicant State will transmit information on the taxpayer and the tax debt to the requested State, after which the latter may proceed to collect the taxes. If the recovery is successful, the amount collected will be paid to the applicant State. The incorporation of such an article contributes to the combat against tax evasion by means of emigration.

35. However, before including an article on assistance in recovery, a contracting State should first examine its own possibilities of assistance in recovery. It is possible that there are obstacles to a convention provision on assistance in recovery. For example, the national legislation must have the possibility of collecting for another State. The inclusion of an article on assistance in recovery is only useful if it is certain that the rendering of the assistance in recovery to other States is not in conflict with the national legislation. The effectiveness of the recovery must be guaranteed. If a tax administration has difficulty collecting its own taxes, the same will probably apply to rendering assistance in recovery to other States. In addition, the legal systems of the contracting States must be comparable. It is conceivable that the systems differ to such a degree that an article on assistance in recovery is not possible. It could be possible that the efficiency of recovery could differ from State to State. If it is likely that the recovery terms will be exceeded by the requested State, a request for assistance will often not be profitable. If both States conclude on the basis of the above-mentioned criteria that an article on assistance in recovery is desired, an article on assistance in recovery may be included in a tax convention. Different alternatives are conceivable.

States may agree to lend each other assistance and support with a view to collecting outstanding tax liability, in accordance with their respective laws or administrative practice, in respect of the taxes to which the Convention may apply and of any increases, surcharges, overdue payments interest and costs pertaining to the said taxes. The contracting State may determine, by mutual consultation, which taxes may apply in the Convention. Usually, it concerns the taxes specified in the United Nations Model Convention and the related interest, fines, increases etc. It is possible to include taxes other than said taxes. Those must then be stated expressly in the article.

36. There are, however, major obstacles to lending assistance in tax collection that have thus far prevented international administrative cooperation through the OECD and United Nations Model Conventions. Those obstacles include both substantive and procedural tax problems. Jurisdiction to deal with both the substantive and procedural aspects of tax collection may involve different arrangements regarding the status of private parties vis-à-vis the faculties, powers, duties and privileges of the tax administration in each State. This makes it difficult to establish generally applicable and agreed measures on a global basis, and it suggests the need for individual responses that are tailored to the structure and administration of the State in question. Furthermore, States tend to be apprehensive about the negative effects on commercial and foreign relations that potentially could result from such cooperative arrangements.

37 Despite those difficulties, it was observed that States nevertheless need to study the mechanisms and guidelines to reinforce cooperation in tax collection. It was pointed out that it is unacceptable in an era of increasing economic globalization for the international community of States to persist in an entrenched attitude based on a rigid conception of sovereignty circumscribed by territorial borders. It was noted that arrangements for cooperation in tax collection were increasingly being accepted and included in the double taxation agreements currently in force. Furthermore, it was suggested that consideration be given to the influence of a new international instrument for promoting international assistance in tax collection: the multilateral Convention on Mutual Administrative Assistance in Tax Matters of the Council of Europe and OECD. It was observed that there are compelling reasons for strengthening administrative cooperation in the recovery of tax claims and authorizing such assistance in international legal agreements. Economic globalization requires the appropriate use of enforcement powers by States to allow the correct application of the tax system and also the need to prosecute fiscal fraud and control tax evasion.

38. International administrative collaboration on tax matters requires explicit regulatory authorization, giving the corresponding tax administration the instruments needed to obtain assistance from the other State and making it a legal duty of the other State to respond to the request for collaboration. Several alternative methods for achieving international administrative cooperation in tax collection were considered, but no preference was expressed for adopting any specific method. There were favourable reports about different countries' experiences with assistance in collection. It was noted that one country has already entered into many conventions that contain an assistance-in-collection article. Several treaties with developing countries are currently under consideration, and at least two treaties with countries with economies in transition have been concluded. It was indicated that one country has received a large number of requests for assistance in collection and had made correspondingly several requests of its treaty partners in this behalf.

39. One member from a developing country described extensively the experience of his country with assistance in collection. Treaties containing such an article have been concluded with many neighbouring countries and with some more distant countries as well. Although experience with those articles is limited, it appears that the process is working successfully and is a two-way street, in that his country is both receiving and making requests under the article. One other participant from a developed country indicated that her country has many agreements providing for assistance in tax collection; in her view, those arrangements are working very smoothly and routinely. There was an emerging consensus that the international climate is moving in favour of an assistance-in-collection article. One developed country that had long opposed such an article was now seriously reconsidering its position.

40. After an extensive discussion of the subject, the Group of Experts decided to make a further in-depth study of the manner in which mutual assistance in collection of tax debts can be achieved.

VII. Other matters

41. The Group of Experts was informed that the United Nations, in association with the Government of China, organized the Second Interregional Training Workshop on International Taxation in Beijing from 23 to 27 April 2001 (the First Workshop was held in Amsterdam from 22 to 26 March 1999). Senior tax administrators of 19 developing countries and economies in transition and the State Administration of Taxation of China participated in the Workshop, the main themes of which were:

(a) Fundamentals of international taxation and the negotiation of bilateral tax treaties between developed and developing countries;

(b) Tax treatment of new financial instruments and globalization of capital markets;

(c) Taxation of electronic commerce.

It is proposed to organize more such workshops in future with a view to upgrading the technical skills of tax administrators of developing countries and economies in transition.

42. The Group of Experts was also informed that the Department of Economic and Social Affairs of the United Nations Secretariat, in cooperation with the Association de planification fiscale et financière, a non-governmental organizatior based in Montreal, organized an ad hoc expert grou p meeting on strategies for improving resource mobi ization in developing countries and countries with economies in transition from 2 to 6 October 2000. The meeting was attended by senior tax administrators of developing countries in Africa, Asia and Latin America and economies in transition, as well as representatives of international financial and professional organizations. Several members of the Group of Experts participated in the meeting as observers.

43. There was a brief discussion of the proposal for the formation of a world tax organization along the lines of the World Trade Organization. One member from a developing country suggested that such an organization may be useful for coordinating international assistance efforts. Another participant noted that that the Group of Experts is currently the most representative body representing Governments around the world on income tax matters.

VIII. Recommendations

44. On the basis of the work of its focus group, the Group of Experts made the recommendations set out below on proposed work on transfer pricing.

Transfer pricing

45. The United Nations has addressed transfer pricing and related issues for many years in many different forums. The Group of Experts recognizes the need for developing and transitional economy countries to improve their ability to develop, implement and administer transfer-pricing rules in accordance with the arm's length principle of article 9 of the United Nations and OECD Model Conventions. To achieve that objective, the Group of Experts has identified two major areas where action through concrete steps will be of particular benefit to developing countries and economies in transition. Specifically, the Group of Experts recommends:

(a) Enhancing policy advice, technical assistance and international cooperation on transfer-pricing issues. In order to provide the maximum benefits to developing countries and economies in transition, technical assistance should be directed at solving the most pressing problems while creating a framework for future developments. Such assistance should include:

(i) Policy advice in the form of short-term evaluation and a support mission to the area at the request of tax authorities from developing countries and economies in transition;

(ii) Technical assistance focusing on industrial and commercial sectors of particular importance to developing countries and economies in transition. For example, the assistance should focus on natural resource extraction industries, commodity producers or contract manufacturing;

(iii) Training on transfer-pricing mechanisms and techniques for settlement of disputes;

(iv) Enhanced and coordinated bilateral assistance from developed countries to developing countries and economies in transition;

(v) The identification of transfer-pricing experts who have the technical background required to provide practical guidance and

assistance to developing countries and economies in transition;

(vi) Enhancement of the dialogue among the developing and transitional economy countries on transfer-pricing issues by providing opportunities for countries with detailed experience on certain transfer-pricing issues to share their experiences with other developing countries and economies in transition;

(vii) Greater coordination between international organizations and the various individual countries that provide technical assistance to developing countries and economies in transition;

(viii) An exploration of the possibility of developing some types of simplified rules (safe harbours) that developing countries and economies in transition might use until they develop the capacity for applying the arm's length principle of article 9 of the United Nations Model Convention. The goal of the simplified rules would be to approximate the results achievable under that principle;

(b) Avoiding and resolving transfer-pricing disputes. Developing countries and economies in transition have found that they have become involved in lengthy and costly disputes with multinational companies over the proper application of the arm's length principle. To avoid such disputes or reduce the costs of resolving the disputes when they occur, the Group of Experts has developed the following list of possible steps:

(i) Procedures should be developed for dealing in a swift and proper manner with requests for an exchange of information relating to transfer pricing under article 26 of the United Nations and OECD Model Conventions;

(ii) Administrative practices should be identified that would permit the tax authorities in developing countries and economies in transition to avoid disputes with taxpayers over interpretation of the arm's length principle. One example of a possible practice would be the publication of explanatory or technical rulings, including rulings developed jointly with trading partners;

(iii) Ways and means of improving the working of the mutual agreement procedure of article 25 of the United Nations and OECD Conventions should be explored;

(iv) Possible alternative methods of resolving disputes, such as mediation and arbitration, should be examined to see if they are compatible with the needs and circumstances of developing countries and economies in transition;

(c) That countries and international organizations consider how to implement the above recommendations so as to achieve the desired improvement in international cooperation and coordination in transfer-pricing and related issues.

Taxation of e-commerce

46. In the light of the potential importance of the taxation of electronic commerce to developing countries and economies in transition, the Group of Experts appointed a focus group to examine the question of proposed work on taxation of electronic commerce. In its report, as approved by the Group of Experts, the focus group found that to a considerable extent, electronic commerce (e-commerce) does not recognize national borders. Because of that feature of e-commerce, its taxation should be considered in a cooperative manner among Governments. Although income from e-commerce is currently not an important part of the tax base of developing countries or economies in transition, it is anticipated that such income will become increasingly important in the future, particularly with respect to business-to-business transactions. Moreover, the increasingly important role of e-commerce has significant implications for tax administration, in particular the widespread adoption of paperless tax reporting and remittance mechanisms, which will inevitably have an impact on all taxing authorities, even those in countries without robust e-commerce economies.

47. In light of the potential importance of the taxation of electronic commerce for developing countries, the Group of Experts recommends that the United Nations undertake a study of the tax issues involved that should address the following three points:

(a) First, whether the concept of permanent establishment, as it is currently understood in law, needs to be changed to take account of the changes in the economic environment that have occurred since it was first adopted as a principle of taxation;

(b) Second, whether particular ways of taxing electronic commerce pose a threat to the tax revenues of developing countries and economies in transition. The study should examine, among other things, the possible impact of electronic commerce and related technological changes on traditional ways for determining the source of income;

(c) Third, whether there are practical ways for developing countries and economies in transition to respond to the potential risks to their tax revenues from electronic commerce. If the study concludes that the concept of permanent establishment in the United Nations Model Convention needs revision, then it should provide alternative treaty language that might be endorsed by the Group of Experts. The study should also suggest the types of changes in the administration of taxes in developing countries and economies in transition that may be required to deal effectively with the challenges posed by electronic commerce to the imposition of taxes on such income in the source country.

Report of the Group of Experts on its tenth meeting and provisional agenda for its eleventh meeting

48. The Group of Experts proposed the following substantive items for inclusion in the provisional agenda of its eleventh meeting:

(a) Revision and update of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*;

(b) Transfer pricing;

(c) Taxation of electronic commerce;

(d) Mutual assistance in collection of tax debts;

(e) New financial instruments;

(f) Intermediation and arbitration;

(g) Protocol for mutual assistance procedure;

(h) Treaty shopping;

(i) Process of financing for development.

49. The Council may wish to take note of the report of the Group of Experts on its tenth meeting and approve the holding of its eleventh meeting, to address the substantive items listed above, in 2003.